

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

Great Northern Utilities, Inc.	:	
	:	
Proposed general increase in water rates.	:	11-0059
(Tariffs filed on December 22, 2010)	:	
	:	
Camelot Utilities, Inc.	:	
	:	
Proposed general increase in water and	:	11-0141
sewer rates.	:	
(Tariffs filed December 30, 2010)	:	
	:	
Lake Holiday Utilities Corporation	:	
	:	
Proposed general increase in water rates.	:	11-0152
(Tariffs filed December 30, 2010)	:	(Cons.)

PROPOSED ORDER

I.	PROCEDURAL HISTORY	1
II.	THE COMPANIES' SERVICE AREAS AND THE NATURE OF OPERATIONS.....	3
III.	TEST YEAR	3
IV.	STIPULATION.....	3
V.	RATE BASE.....	4
A.	UNCONTESTED ISSUES	4
1.	<i>Deferred Charges</i>	<i>4</i>
2.	<i>Accumulated Depreciation.....</i>	<i>4</i>
3.	<i>Utility Plant – Abandoned Well</i>	<i>4</i>
4.	<i>Utility Plant – Pro Forma Plant Additions.....</i>	<i>5</i>
5.	<i>Deferred Charges – Disallowed Pro Forma Plant Addition</i>	<i>5</i>
6.	<i>Deferred Charges – Tank Painting.....</i>	<i>5</i>
7.	<i>Working Capital</i>	<i>5</i>
8.	<i>Depreciation Rates</i>	<i>6</i>
B.	CONTESTED ISSUES	6
1.	<i>Overall Amount of Rate Bases</i>	<i>6</i>
a)	AG's Position	6
b)	Staff's Position.....	7
c)	Companies' Position.....	7
d)	Commission Analysis and Conclusions	8
2.	<i>Project Phoenix.....</i>	<i>9</i>
a)	The Association's Position	9
b)	Staff's Position.....	9
c)	Companies' Position.....	9
d)	Commission Analysis and Conclusion	10
3.	<i>100,000 Gallon Water Storage Tank</i>	<i>10</i>
a)	The Association's Position	10
b)	Staff's Position.....	10
c)	Companies' Position.....	11
d)	Commission Analysis and Conclusion	11
4.	<i>Well No. 2</i>	<i>11</i>
a)	The Association's Position	11
b)	Staff's Position.....	13
c)	Companies' Position.....	13
d)	Commission Analysis and Conclusion	13
C.	COMMISSION CONCLUSION ON RATE BASES	13
VI.	OPERATING REVENUES, EXPENSES, AND INCOME	15
A.	UNCONTESTED ISSUES	15
1.	<i>Public Utility Taxes and Gross Revenue Tax</i>	<i>15</i>
2.	<i>State Income Tax Rate</i>	<i>17</i>
3.	<i>Rate Case Expense</i>	<i>17</i>
4.	<i>Maintenance Expenses</i>	<i>18</i>
5.	<i>CPI Increases</i>	<i>18</i>
6.	<i>Income Taxes</i>	<i>18</i>
7.	<i>Gross Revenue Conversion Factor</i>	<i>18</i>
B.	CONTESTED ISSUES	19
1.	<i>Allocation Factor Corrections.....</i>	<i>19</i>
a)	AG's Position	19
b)	Staff's Position.....	21
c)	Companies' Position.....	21
d)	Commission Analysis and Conclusion	21
2.	<i>Camelot Estates Water System Study</i>	<i>22</i>

a)	The Association's Position	22
b)	Staff's Position	22
c)	Companies' Position	23
d)	Commission Analysis and Conclusion	23
C.	COMMISSION CONCLUSION ON OPERATING REVENUES, EXPENSES, AND INCOME	23
VII.	RATE OF RETURN	24
A.	CAPITAL STRUCTURE	25
B.	COST OF DEBT	25
C.	COST OF COMMON EQUITY	26
1.	<i>DCF Analysis</i>	26
2.	<i>Risk Premium Analysis</i>	27
3.	<i>Staff Cost of Equity Recommendation</i>	27
4.	<i>AG Cost of Equity Recommendation</i>	28
5.	<i>Commission Analysis and Conclusions</i>	28
VIII.	RATE DESIGN/TARIFF TERMS	31
A.	RATE DESIGN	31
B.	MISCELLANEOUS	31
1.	<i>After-Hours Call-Out Charge</i>	31
2.	<i>Reconnection Charge</i>	31
3.	<i>Non-Sufficient Funds Charge</i>	31
4.	<i>New Customer Charge</i>	32
5.	<i>Billing Cycles</i>	32
6.	<i>Customer Bill Form</i>	32
7.	<i>Tariff Updates</i>	32
C.	RULES, REGULATIONS, AND CONDITIONS OF SERVICE TARIFFS	33
D.	COMMISSION ANALYSIS AND CONCLUSIONS	34
IX.	RATE SHOCK	35
A.	AG'S POSITION	35
C.	STAFF'S POSITION	36
D.	COMPANIES' POSITION	37
E.	COMMISSION ANALYSIS AND CONCLUSIONS	38
X.	FINDINGS AND ORDERING PARAGRAPHS	39

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PROPOSED ORDER

By the Commission:

I. Procedural History

On December 22, 2010, Great Northern Utilities, Inc. (“Great Northern” or “GNUI”) filed revised tariff sheets in which it proposed a general increase in water rates to be effective February 5, 2011. These tariff sheets were identified as Ill. C. C. No. 3, Twelfth Revised Sheet No. 1, and Ill. C. C. No. 3, Original Sheet No. 1.1.

On December 30, 2010, Camelot Utilities, Inc. (“Camelot” or “CUI”) and Lake Holiday Utilities Corporation (“Lake Holiday” or “LHUC”) separately filed revised tariff sheets in which they proposed a general increase in water rates and also sewer rates in the case of Camelot to be effective February 14, 2011. Camelot’s tariff sheets were identified as Ill. C. C. No. 3 (sewer), Seventh Revised Sheet No. 1; Ill. C. C. No. 3 (water), Eight Revised Sheet No. 1, and Ill. C. C. No. 3, Original Sheet No. 1.1. Lake Holiday’s tariff sheets were identified as Ill. C. C. No. 1, Ninth Revised Sheet No. 1, and Ill. C. C. No. 1, Original Sheet No. 1.1.

On January 20, 2011 and February 9, 2011, the Illinois Commerce Commission (“Commission”) entered Orders suspending the revised tariff sheets to and including May 20, 2011, in the case of Great Northern, and May 29, 2011, in the case of Camelot and Lake Holiday. On May 4, 2011 and May 18, 2011, the Commission resuspended the revised tariff sheets to and including November 20, 2011, in the case of Great

Northern, and November 29, 2011, in the case of Camelot and Lake Holiday. At a status hearing on March 10, 2011, an oral motion made by Staff of the Commission ("Staff") to consolidate Docket Nos. 11-0059, 11-0141, and 11-0142 was granted.

Notices of the proposed increase in water and sewer rates were posted and published in a newspaper of general circulation throughout the areas served by Great Northern, Camelot, and Lake Holiday (collectively, the "Companies" or the "Utilities") in accordance with the requirements of Section 9-201 of the Public Utilities Act ("Act") and the provisions of 83 Ill. Adm. Code 255. Each of the Companies also sent notice of the filing to customers in its first billing after the filing.

Leave to Intervene was granted to the Camelot Homeowner's Association (the "Association") and the People of the State of Illinois (the "Attorney General" or the "AG") (collectively, the "Intervenors").

Pursuant to notice as required by the law and the rules and regulations of the Commission, an evidentiary hearing was held before a duly authorized Administrative Law Judge ("ALJ") of the Commission at its offices in Chicago, Illinois on July 13, 2011 and July 14, 2011. At the evidentiary hearing, the Utilities, Staff, the Association, and the Attorney General appeared and presented testimony. The record was subsequently marked "Heard and Taken."

The Companies presented the following joint witnesses: Bruce Haas, Regional Director of Operations for the Midwest Region of Utilities, Inc. ("UI") and its subsidiaries; and Steven M. Lubertozzi, Executive Director of Regulatory Accounting and Affairs for UI and its subsidiaries. Mr. Lubertozzi adopted the direct testimony submitted by Lena Georgiev, who had submitted testimony as Regulatory Manager for the Atlantic and Midwest Regions of UI at the time the cases were filed.

The following witnesses testified on behalf of Staff: Phillip Rukosuev, Cheri Harden and Christopher Boggs, Rate Analysts in the Rates Department of the Financial Analysis Division; William R. Johnson and Thomas Q. Smith, Economic Analysts in the Water Department of the Financial Analysis Division; Jonathan M. Sperry, a Water Engineer in the Water Department of the Financial Analysis Division; Mike Ostrander and Richard W. Bridal II, Accountants in the Accounting Department of the Financial Analysis Division; and Janis Freetly, a Senior Financial Analyst in the Finance Department of the Financial Analysis Division. The Association offered the testimony of 19 residents in the Camelot subdivision. The Attorney General offered the testimony of Roger D. Colton, a Consultant and Attorney.

At the hearing, the Companies and Staff advised the ALJ that they had entered into a Stipulation resolving all issues that had been disputed between them. Pursuant to the Stipulation, the Companies agreed to Staff's recommended revenue requirement, as well as all accounting adjustments recommended by Staff's witnesses in their direct and rebuttal testimony. (Staff-Companies Joint Ex. No. 1 REV. at 2-3). The Association and the Attorney General are not parties to the Stipulation.

II. The Companies' Service Areas and the Nature of Operations

The Companies are wholly-owned subsidiaries of UI, which owns and operates water and/or wastewater systems throughout the United States. Water Service Corporation ("WSC") manages the operations for all of UI's water and sewer systems, including Great Northern, Camelot, and Lake Holiday. WSC provides management, administration, engineering, accounting, billing, data processing, and regulatory services for the utility systems. WSC's expenses are assigned directly to an operating utility, or they are allocated to one or more of the various operating utilities, pursuant to a formula that has been approved by this Commission.

Great Northern provides water service to approximately 360 customers in Winnebago County, Illinois. Great Northern's current water rate structure was approved pursuant to an Order, dated October 21, 1998, in Docket No. 98-0047. Camelot provides water and sewer service to approximately 200 customers in Will County, Illinois. Camelot's current water and sewer rate structure was approved pursuant to an Order, dated July 8, 1993, in Docket No. 92-0345. Lake Holiday provides water service to approximately 2,000 customers in LaSalle County, Illinois. Lake Holiday's current water rate structure was approved pursuant to an Order, dated August 4, 1993, in Docket No. 92-0420.

III. Test Year

The Companies' filings are based on a historical test year ending December 31, 2009, with pro forma adjustments for known and measurable changes. Neither Staff nor Intervenor challenged the reasonableness of using the year 2009 as a historical test year.

The Commission concludes that the test year ending December 31, 2009, with adjustments for known and measurable changes, is appropriate for the purposes of this proceeding.

IV. Stipulation

The Stipulation between the Companies and Staff sets forth the resolution of all issues that had been disputed between them. The Companies agree in the Stipulation to Staff's recommended revenue requirement, as well as all accounting adjustments and water and sewer rates recommended by Staff's witnesses in their direct and rebuttal testimony. (Staff-Companies Joint Ex. No. 1 REV. at 2-3). The Intervenor is not a party to the Stipulation and they urge the Commission to reject the Stipulation.

In *Business and Professional People for the Public Interest v. Illinois Commerce Commission*, 136 Ill. 2d 192 (1989) ("BPP"), the Illinois Supreme Court outlined in considerable detail the Commission's authority to entertain and adopt a settlement. The Court made clear that this Commission is not foreclosed from entertaining and adopting a non-unanimous settlement if the following three conditions are met: (1) the provisions

of the settlement agreement must be within the Commission's authority to impose; (2) the provisions must not violate the Act; (3) and substantial evidence must exist in the record to independently support the provisions of the proposed settlement. (*Id.*).

The Stipulation is a non-unanimous settlement. Thus, we will conduct a *BPI* analysis and base our determinations and ultimate conclusions on the record evidence. Accordingly, the Stipulation will be treated as merely another proposed resolution for the various contested issues addressed in this proceeding that must be considered based on the record evidence adduced in the dockets.

V. Rate Base

In their testimony, the Companies presented evidence showing their original cost rate bases after pro forma adjustments for the test year ending December 31, 2009. Staff proposed various adjustments to the Companies' rate bases. Staff's proposed adjustments are summarized in the sections below and are reflected in Appendices A and B. The Companies accepted all of Staff's recommended rate base adjustments. The Intervenor, however, seek additional adjustments.

A. Uncontested Issues

1. Deferred Charges

Staff witness Ostrander proposed adjustments to remove deferred charges from the Companies' rate bases because the Commission has not authorized the deferral. (Staff Ex. 1.0, Schedules 1.09). The instructions to Account 186, Miscellaneous Deferred Debits, require the Commission's authority for the deferral of costs. The Companies did not contest these adjustments. (GNUI/CUI/LHUC Ex. 3.0 at 5). These adjustments are reasonable and are hereby approved.

2. Accumulated Depreciation

Staff witness Ostrander proposed an adjustment to correct Great Northern's accumulated depreciation for the misclassification of land as a depreciable asset. (Staff Ex. 1.0, Schedule 1.10 GN). In 2008, Great Northern purchased land for use as a septic field. The capitalized cost was recorded in Account 320 Water Treatment Equipment and depreciation expense was reflected for 2008 and 2009 with a corresponding impact to accumulated depreciation. Land has no depreciable value and therefore should have been recorded in Account 303 Land and Land Rights. Great Northern did not contest this adjustment. (GNUI/CUI/LHUC Ex. 3.0 at 3). This adjustment is reasonable and is hereby approved.

3. Utility Plant – Abandoned Well

Staff witness Ostrander proposed an adjustment to reduce the test year utility plant amount for utility plant that has been retired, and is no longer used and useful, but

is included in gross utility plant in Camelot's filings. (Staff Ex. 1.0, Schedule 1.11 C-W). Corresponding adjustments to accumulated depreciation and depreciation expense were made. Camelot did not contest these adjustments. (GNUI/CUI/LHUC Ex. 3.0 at 4). These adjustments are reasonable and are hereby approved.

4. Utility Plant – Pro Forma Plant Additions

Staff witness Ostrander proposed adjustments to reflect the changes in Camelot's water utility plant, accumulated depreciation, accumulated deferred income taxes, and test year depreciation expense due to the reclassification of the estimated costs of capital projects from deferred charges to pro forma plant additions. (Staff Ex. 1.0, Schedule 1.12 C-W). These capital projects qualify as pro forma plant additions and along with the other components of rate base, are known and measurable, reasonably certain to occur subsequent to the 2009 historical test year and within 12 months after the filing date of the tariffs, and the amounts are determinable. Camelot did not contest these adjustments. (GNUI/CUI/LHUC Ex. 3.0 at 4). These adjustments are reasonable and are hereby approved.

5. Deferred Charges – Disallowed Pro Forma Plant Addition

Staff witness Ostrander proposed adjustments to reflect the changes in Lake Holiday's utility plant, accumulated depreciation, and test year depreciation expense due to the disallowance of a pro forma plant addition. (Staff Ex. 1.0, Schedule 1.13 LH). Lake Holiday, in its initial filing, classified a ground storage tank pro forma plant addition as a deferred charge. The Company subsequently acknowledged that the ground storage tank project has been moved to a future date due to budget constraints. This deferred project is not known and measurable and is therefore not in accordance with 83 Ill. Adm. Code 287.40. Lake Holiday did not contest these adjustments. (GNUI/CUI/LHUC Ex. 3.0 at 4). These adjustments are reasonable and are hereby approved.

6. Deferred Charges – Tank Painting

Staff witness Ostrander proposed an adjustment to reflect the deferred cost of tank painting, net of amortization, in Lake Holiday's rate base. (Staff Ex. 1.0, Schedule 1.14 LH). The costs incurred for the tank painting are deferred and amortized over the expected life of the improvement of the asset. Lake Holiday is entitled to recover the cost of the betterment which is shown net of amortization in the proposed adjustment. Lake Holiday did not contest this adjustment. This adjustment is reasonable and is hereby approved.

7. Working Capital

Staff witness Ostrander proposed adjustments to working capital for the removal of real estate taxes and to incorporate the effects of other Staff-proposed adjustments. (Staff Ex. 10.0, Schedules 10.08). The Companies did not contest the removal of real

estate taxes from the working capital calculation. (GNUI/CUI/LHUC Ex. 3.0 at 3). These adjustments should be updated to reflect the operating expenses approved by the Commission. These adjustments are reasonable and are hereby approved.

8. Depreciation Rates

Staff witness Johnson proposed some adjustments to the Companies proposed water and sewer depreciation rates. The resulting depreciation rates are identified on Staff Ex. 9.0, Schedules 9.01 C-W, 9.01 C-S, 9.01 GN, and 9.01 LH. The proposed sewer depreciation rates produce a test year ending December 31, 2009 annual sewer depreciation expense of \$32,773, excluding depreciation expenses associated with WSC. The Companies agreed with Staff's proposed depreciation rate adjustments. These adjustments are reasonable and are hereby approved.

B. Contested Issues

1. Overall Amount of Rate Bases

a) AG's Position

The AG asserts that the Companies failed to meet their burden of proof to show that the proposed increases in the Companies' rate bases were prudently incurred and are just and reasonable. The AG argues that the Companies did not identify any reasons to justify the proposed increases other than by identifying the items mentioned in the testimony of the Companies' witness Haas and in the AG's data request admitted as AG Cross Exhibit 1, 2, and 3 which includes the Companies' itemization of capital improvements. (AG Initial Brief at 12). The AG maintains that the amount identified in the Companies' testimony and AG Cross Exhibit 1, 2, and 3 is substantially less than the more than \$1 million the Companies claim was invested in each utility. The AG states that given the large rate increases requested by the Companies and the limited justification for the increases in rate base, the Commission should limit the increases to the rate bases to the amount identified in AG Cross Exhibit 1, 2, and 3. The rate base for each Company would be reduced as follows: Great Northern by \$381,265, Camelot by \$954,444, and Lake Holiday by \$1,447,865. (AG Draft Proposed Order (August 19, 2011) at 5).

At the hearing, the Companies' witness Haas was asked about the items that made up more than \$1 million in "total net plant additions" that Mr. Haas testified were added to the rate base of each Company. GNUI Ex. 2.0 at 4; CUI Ex. 2.0 at 4; LH Ex. 2.0 at 4. AG Cross Exhibits 1, 2 and 3 were admitted, which consist of the Companies' itemization of investment in answer to the question to "identify the year of completion and the amount expended for each capital improvement identified in the Direct Testimony of Bruce T. Haas." The AG argues that the total expenditures for the items included in Mr. Haas's testimony are substantially less than the more than \$1 million the Companies claim was invested in each utility. The AG further argues that the

Companies provided no other explanation for the large increase in rate base requested in these dockets.

The AG asserts that the Companies failed to meet their burden of proof to show that the extremely large increases in rate base resulting from the Joint Stipulation were prudently incurred and are just and reasonable. The AG pointed out that compared to 2000, Great Northern's rate base increased from \$190,356 to \$1,363,881 or more than 600% and Camelot's water and sewer rate base increased from \$588,213 to \$1,630,362 or more than 175%. Lake Holiday is requesting a rate base of \$1,621,701. The Companies did not identify any reasons for increases in rate base other than by identifying the items mentioned in their testimony and in AG Cross Exhibits 1, 2, and 3. Given the huge rate increases requested by the Companies and the limited justification for the increases in rate base, the AG recommended that the Commission limit the increase to rate base to the amount identified by the Companies in Mr. Haas' testimony and in these cross exhibits.

The AG also questions the reasonableness and prudence of investing more than \$1 million per utility in light of the Companies' claims that they need large rate increases. (~~Id.~~AG Draft Proposed Order at 10). The AG asserts that sudden and large rate increases should not be permitted in the absence of a clear explanation and justification because such increases (1) violate the concept of gradualism and predictability that underlies the regulatory compact; (2) raise credibility questions in light of the utility's duty and incentive to maintain appropriate rates so that shareholders receive a fair return on their investment because one would not expect investments of this magnitude to be made in the absence of sufficient revenues to pay a return; and (3) deny the Commission the opportunity and power to review the size of investment relative to the rate impact as the need for investments arises.

b) Staff's Position

Staff challenges the AG's argument that the reasonableness and prudence of some of the Companies' investments should be questioned. Staff specifically takes issue with the AG's argument that the Companies did not justify the increase to Great Northern's rate base from the purchase of ion exchange equipment. (Staff Reply Brief at 18). Great Northern testified that this equipment was installed for softening and radium removal needs. Furthermore, it appears radium removal equipment may be necessary to meet environmental standards and ion exchange is determined to be one of the best available technologies for radium removal. From 2003 to 2008, the Great Northern-Coventry Creek water system was cited by the Illinois Environmental Protection Agency ("IEPA") for violation of the combined radium MCL. (*Id.*). However, after purchasing the ion exchange equipment, the IEPA reported that the water system had returned to compliance as of July 2010. Therefore, it was appropriate for Great Northern to purchase the equipment and for the cost to be included in rate base.

c) Companies' Position

The Companies dispute the AG's claims that they failed to explain the reason for the differences between the total rate base increases since the last rate cases and the examples described in the Companies' direct testimony. (Companies Reply Brief at 13). The Companies argue that the witness explained that the difference was attributable to general ledger additions, i.e. the many small projects the Companies invested in over the course of the 15 or 18 years since the last test years. The Companies' point out that all of the projects are supported by the Companies' audited accounting records and continuing property records, which were reviewed by Staff and available for the AG to review. (*Id.*). The Companies maintain that it would be an impossible burden for the Companies to provide testimony about every single general ledger addition, such as a main or pump replacement, for even one year. Requiring such an extensive itemization in testimony would cause rate cases to go on for years and the additional expenses would be significantly larger. The Companies assert that neither the Commission nor the courts have imposed such a burden on utilities in rate cases. (*Id.*).

d) Commission Analysis and Conclusions

~~The Commission declines to adopt the AG's proposal to reduce the rate bases proposed by Staff. The evidence in the record demonstrates that the Companies' investments were necessary to meet their public utility service obligations. The Commission disagrees with the AG's assumption that every single capital improvement must be itemized to justify a rate increase. The record supports the Companies' statement that the increases in the Companies' rate bases are due to general ledger additions all of which are supported by the Companies' audited accounting records and property records which Staff thoroughly reviewed. Additionally, the Commission does not believe it would be appropriate to penalize a utility that has chosen not to increase customer rates for many years.~~

The Commission accepts the Staff adjustment which the Companies do not contest. In addition, the Commission finds that the Companies have not shown that the extraordinary increase in rate base they request is prudent, just or reasonable, and the Commission reduces the rate base in the Joint Stipulation to eliminate the rate base amounts that have not been justified or addressed by the Companies in the record.

The Commission concludes that the Companies have not met their burden to prove that the increases in rate base for these small companies were prudently incurred. The Public Utilities Act puts the burden of proof squarely on the utility in seeking to increase rates. 220 ILCS 5/9-201(c). In these dockets, the utilities only addressed a small subset of capital investments, and the details of those investments are only in the record in the form of AG Cross Exhibits 1, 2 and 3. When consumers are facing increases of the magnitude requested in these dockets, it is imperative that the reasons for the increases be included in the record both for Commission review and so the public can understand what is driving their rates up.

The Commission will only approve increases in rate base justified by AG Cross Exhibits 1, 2 and 3. As a result, we decrease the rate base in the Stipulation by the following:

<u>Great Northern</u>	<u>Camelot Water and Sewer</u>	<u>Lake Holiday</u>
<u>(381,265)</u>	<u>(954,444)</u>	<u>(1,447,865)</u>

2. Project Phoenix

a) The Association's Position

The Association proposes adjustments to disallow recovery of the costs related to a project initiated by UI entitled Project Phoenix to replace the information technology infrastructure it utilizes for accounting, customer care and billing. As part of Project Phoenix, UI selected JD Edwards Enterprise One ("JDE") as its accounting or financial system and Oracle's Customer Care and Billing System ("CC&B") as its customer information system. The Association argues that the total cost of the JDE software should be excluded because the software is for general office use and management and is not directly linked to service for public utility customers. (Association Initial Brief at 25). The Association posits that customers should not be forced to pay for general office software improvements for UI that do not directly benefit them. In addition, the Association argues that although the CC&B software appears to be more closely linked with customer service, the relevant percentage of the cost of the CC&B software that is not directly related to customer service should also be excluded from rate base. (*Id.* at 26).

b) Staff's Position

Staff argues that the Associations' proposal to disallow recovery of the costs related to Project Phoenix should be rejected. Staff states that it is perplexing that the Association believes the JDE software, which is accounting software is "not directly linked to service for public utility customers" and "[does] not directly benefit them." (Staff Reply Brief at 12). In addition, Staff argues that the Association does not state what portion of the CC&B software should also be excluded from rate base or adequately explain why any amount should be disallowed. (*Id.*). According to Staff, this naked assertion should be rejected for lack of specificity.

c) Companies' Position

The Companies assert that the Association's proposal to disallow recovery of the costs related to Project Phoenix is contrary to the record evidence. They point out that the Commission has previously allowed recovery of similar system replacements. (See Docket Nos. 09-0548 and 09-0549, Order (September 9, 2010)). The Companies explain that they provided un rebutted testimony regarding the need for and benefits of

the replacement systems. The JDE accounting system is used by the Companies for asset management and to maintain the detailed accounting records required by the Commission and taxing authorities. The Companies posit that customers obviously benefit by having the utility maintain accurate accounting records and the costs it incurs to serve its customers. (Companies Reply Brief at 10).

d) Commission Analysis and Conclusion

The Commission finds that the investments related to the replacement of the information technology infrastructure used by the Companies are reasonable and should be included in rate base. The evidence in the record demonstrates that the new billing and accounting programs benefit the Companies' customers in numerous ways, allowing them to operate more efficiently and with more accuracy. The Association failed to adequately explain why these programs are not directly linked to service of public utility customers. The Commission concludes that the software at issue here is used and useful in providing utility service to customers and is appropriately included in rate base.

3. 100,000 Gallon Water Storage Tank

a) The Association's Position

The Association asserts that the investment Camelot seeks to include in rate base for its proposed 100,000 gallon water storage tank at the Camelot subdivision should be excluded because the tank is not yet used and useful and it is outside of the 2009 test year. The Association notes that Camelot stated that construction started in April 2011 and that it will be complete and in service in the third quarter of 2011. However, Camelot witness Haas admitted on cross examination that Camelot has not yet been able to begin on-site construction of the tank because Camelot has not received approval from the IEPA. (Association Initial Brief at 29). For this reason, the Association argues Camelot may not include any of the costs for this project in rate base since the tank is not currently used and useful.

b) Staff's Position

Staff argues that the cost of the water storage tank should not be excluded from rate base because it is a pro forma plant addition. Staff points out that the Association states in its own brief that "the project will be complete and in service in the third quarter of 2011." (Staff Reply Brief at 12). Staff further explains that while the Association points out Camelot witness Haas' admission that on-site construction has not yet begun, it does not rebut Camelot's projection for the water storage tank's in-service date. Staff asserts that Camelot's project is supported by construction cost estimates from an engineering firm and is planned to be in service by the end of 2011. (Staff Ex. 1.0 at 15). Therefore, Staff insists the project qualifies as a pro forma plant addition pursuant to 83 Ill. Adm. Code 287.40 as it is known and measurable, reasonably certain to occur

subsequent to the historical test year within 12 months after the filing date of the tariffs, and the cost is determinable. (*Id.*).

c) Companies' Position

The Companies argue that the Association's proposed adjustment to disallow the cost of the water storage tank must be denied. The Association acknowledges the project will be complete in the third quarter of 2011 and provides no evidence to the contrary. The Companies point out the Commission rules which allow recovery of pro forma adjustments to the test year for known and measurable changes expected to occur within 12 months from the filing of the rates. (Companies Reply Brief at 9). The Companies note that Staff specifically addressed this issue and recommended the recovery. The Companies cite *Consumer Illinois Water Company*, Docket No. 97-0351, Order (June 17, 1998), which states that "the rule does not indicate that pro forma adjustments should be disallowed because they are based on something less than absolute certainty. Rather adjustments should be disallowed where they reflect significant changes reasonably anticipated to occur." (*Id.*).

d) Commission Analysis and Conclusion

Camelot's proposed water storage tank qualifies as a pro forma plant addition under 83 Ill. Adm. Code 287.40 because the record evidence shows it is known and measurable, reasonably certain to occur subsequent to the historical test year within 12 months after the filing date of the tariffs, and the cost is determinable. The record demonstrates Camelot provided detailed information concerning its plans to construct the water storage tank, cost estimates from an engineering firm, and evidence that it is likely to occur within the time period provided by the regulation. The Association failed to provide evidence to the contrary. Accordingly, the Commission finds that the inclusion of the investments related to Camelot's proposed water storage tank is reasonable and supported by the evidence in the record.

4. Well No. 2

a) The Association's Position

The Association contends that any costs related to Well No. 2 subsequent to it being capped should be excluded. In addition, the Association proposed that the costs of capping Well No. 2 should be excluded because Camelot learned of the lack of viability of the well prior to the 2009 test year but delayed capping it until the end of the test year and did not book the retirement of the well during the test year. (Camelot Initial Brief at 30). It is the Association's position that if Camelot learned of the lack of viability of Well No. 2 in 2008, it should not be able to recover the costs of capping the well by waiting until the last month of the test year to seal the well. See *Business and Professional People for Public Interest v. Illinois Commerce Commission*, 146 Ill. 2d 175, 238 (1991) (noting that the purpose of the test-year rule is to prevent a utility from overstating its revenue requirement by compiling high expense data from a different

year). The Association also argues that Camelot admitted the retirement of Well No. 2 was not booked. Since such retirement was not booked in the test year, the Association maintains Camelot should not be able to include these costs in this proceeding. (*Id.*).

b) Staff's Position

Staff argues that the Association failed to identify the costs it claims were incurred subsequent to Well No. 2 being capped. Staff explains that the costs identified by the Companies include rehabilitation and inspection in 2006 and that the well was abandoned and sealed in December 2009. Staff believes the sealing and abandonment of Well No. 2 was a prudent cost of doing business, and that such action was necessary to meet the requirements of environmental and public health regulations. (Staff Reply Brief at 13). Furthermore, Staff explains that it proposed adjustments which were accepted by the Companies to utility plant and related accumulated depreciation to account for the fact Well No. 2 has been retired and is no longer used and useful. (Staff Ex. 1.0 at 13.)

c) Companies' Position

The Companies argue that the Association does not identify the amount that should be excluded for investments related to Well No. 2 so it is impossible to know what exactly the Association thinks needs to be removed. (Companies Reply Brief at 9). In addition, contrary to the Association's attempt to claim credit for bringing the abandonment of the well to light, the Companies note that Staff's direct testimony proposed an adjustment to reflect the retirement of Well No. 2 and the Companies agreed to the adjustment. The Companies also argue that the entries to reflect the retirement are governed by the Commission's Uniform System of Accounts and have already been incorporated in the revenue requirement recommended in Staff's schedules.

d) Commission Analysis and Conclusion

The Commission finds that Camelot's investments related to Well No. 2 are legitimate costs incurred in the course of doing business during the 2009 test year. In addition, these costs were necessary to comply with all applicable environmental and public health regulations. The Commission also concludes that Staff's adjustment has addressed the fact that the well was retired and is no longer used and useful in providing utility service. The Association argued that costs related to Well No. 2 after it was capped should be excluded but the Association failed to identify these costs. Thus, the Commission finds that the investments included in rate base related to Well No. 2, as adjusted by Staff, are reasonable and should be reflected in the revenue requirement.

C. Commission Conclusion on Rate Bases

The Commission finds that Staff's adjustments to the Companies' rate bases are supported by the evidence, reasonable, and should be adopted. Upon giving effect to these adjustments, the Commission concludes that the rate bases approved for purposes of this proceeding are: \$1,~~363,884~~000,474 for Great Northern,

~~\$1,002,814,869,318 for Camelot (water) and \$627,548 (sewer) for Camelot,~~ and \$1,621,701,14,650 for Lake Holiday. These rate bases may be summarized as follows:

Great Northern Approved Rate Base

	<u>Water</u>
Gross Plant in Service	\$1,810,228
Less: Accumulated Depreciation and Amortization	<u>(\$327,093)</u>
Net Plant	\$1,483,135
Additions to Rate Base	
Working Capital	\$15,430
ADIT Regulatory Asset	\$1,071
Deductions from Rate Base	
Contributions in Aid of Construction	(\$94,720)
Accumulated Deferred Income Taxes	(\$40,972)
Customer Deposits	(\$41)
Adjustments to Rate Base Allocations	(\$22)
<u>AG Adjustment</u>	<u>(\$363,407)</u>
Rate Base	<u>\$1,363,8810</u> <u>00,474</u>

Camelot Approved Rate Base

	<u>Water</u>	<u>Sewer</u>
Gross Plant in Service	\$1,301,286	\$1,096,608
Less: Accumulated Depreciation and Amortization	<u>(\$143,621)</u>	<u>(\$292,460)</u>
Net Plant	\$1,157,665	\$804,148
Additions to Rate Base		
Working Capital	\$10,851	\$13,179
ADIT Regulatory Asset	\$2,676	\$5,723
Deductions from Rate Base		
Contributions in Aid of Construction	(\$54,284)	(\$81,162)
Accumulated Deferred Income Taxes	(\$114,081)	(\$114,327)
Adjustments to Rate Base Allocations	(\$13)	(\$13)
Rate Base	<u>\$1,002,814</u>	<u>\$627,548</u>
<u>AG Adjustment – combined water and sewer</u>	<u>(\$761,044)</u>	
<u>Combined rate base</u>	<u>\$869,318</u>	

Lake Holiday Approved Rate Base

	<u>Water</u>
Gross Plant in Service	\$2,887,203
Less: Accumulated Depreciation and Amortization	<u>(\$1,010,528)</u>
Net Plant	\$1,876,675
 Additions to Rate Base	
Working Capital	\$49,404
Deferred Charges	\$117,000
ADIT Regulatory Asset	\$9,919
 Deductions from Rate Base	
Contributions in Aid of Construction	(\$296,168)
Accumulated Deferred Income Taxes	(\$135,003)
Adjustments to Rate Base Allocations	(\$126)
<u>AG Adjustment</u>	<u>(\$1,607,051)</u>
 Rate Base	 <u><u>\$1,621,701.14</u></u> <u>.650</u>

VI. Operating Revenues, Expenses, and Income

The Companies presented their pro forma operating revenues, expenses, and income for the test year ended December 31, 2009. Staff proposed various adjustments to the Companies' pro forma operating statements. In addition, Staff made recommendations regarding tariff language changes and additional information to be provided by the Companies and UI's Illinois regulated utilities in future rate case direct testimony. Staff's proposed adjustments and recommendations are summarized below and reflected in Appendices A, B, C, and D. The Companies accepted all of Staff's recommendations and adjustments. The Intervenor, however, recommend additional adjustments.

A. Uncontested Issues**1. Public Utility Taxes and Gross Revenue Tax**

Staff witness Bridal proposed an adjustment to remove public utility taxes. He explained that the taxes, which are an add-on charge to customers' bills, are not an actual operating expense of the utility and should not be included in tariffed rates. (Staff Ex. 2.0 at 4-5). Also, Mr. Bridal recommended the Companies proceed in an expeditious manner to make the arrangements necessary to collect the Gross Revenues tax as a separate charge on customers' bills when the rates approved in this docket go into effect. (Staff Ex. 2.0 at 5). In conjunction with this change, Mr. Bridal recommended the Companies add the following language to their tariffs.

ANNUAL GROSS REVENUE TAX RECOVERY CHARGE

Section 9-222 of "The Public Utilities Act," as amended, authorizes a utility to recover from its Customers its liabilities to the State of Illinois for Public Utility Annual Gross Revenue Tax imposed by Section 2-202 of "The Public Utilities Act," as amended. Pursuant to Section 9-222, the Company shall charge an Additional Charge for the Public Utility Annual Gross Revenue Tax equal to 0.1 % of all billings under this rate schedule except for (a) this Additional charge for Public Utility Annual Gross Revenue Tax, (b) the Additional Charge for any Municipal Utility Tax, and (c) any other billings and billing items excluded from the base of the Public Utility Annual Gross Revenue Tax. (*Id.*).

The Companies agreed with Staff's adjustment and recommended tariff language. (GNUI/CUI/LHUC Ex. 3.0 at 6). This adjustment and recommendation are reasonable and are hereby approved.

2. State Income Tax Rate

Staff witness Bridal proposed adjustments to reflect the impact of the increase in the Illinois State Income Tax ("SIT") rate from 7.3% to 9.5%, effective January 1, 2011, as follows: (1) increase state income tax expense; (2) increase Accumulated Deferred Income Tax ("ADIT") for the shortfall resulting from the tax rate increase, to be recognized as a decrease to rate base; (3) create a corresponding regulatory asset for the future recovery of that additional ADIT liability, to be recognized as an increase to rate base; and (4) amortize the regulatory asset ratably over the remaining life of the depreciable assets that gave rise to the ADIT. (Staff Ex. 2.0 at 6-8). The Companies agreed with Staff's adjustment. (GNUI/CUI/LHUC Ex. 3.0 at 3). This adjustment is reasonable and is hereby approved.

3. Rate Case Expense

Staff witness Bridal proposed an adjustment to rate case expense to: (1) adjust the estimate for legal fees, (2) adjust costs for customer notices, FedEx, mailings, postage, and miscellaneous costs, (3) remove travel costs, (4) decrease the cost of WSC personnel, (5) adjust consulting fees, and (6) change the amortization period for rate case expense to five years from the three years proposed by the Companies. (Staff Ex. 2.0 at 8-13). In rebuttal testimony, the Companies provided additional detailed explanations of how the Companies account for rate case expense, and provided updated information on incurred rate case expense as of the filing of their rebuttal testimony, along with an estimate of rate case expenses through the conclusion of the proceedings. (GNUI/CUI/LHUC Ex. 3.0 at 6-14). Staff accepted rate case expense as set forth in GNUI/CUI/LHUC Ex. 3.0 subject to one recommendation. Staff recommends the Commission order the Companies, and all related UI public utilities regulated in Illinois, to provide in direct testimony in future rate cases a detailed explanation of how Utility and WSC salaries are determined in total, allocated to the individual Utility, and directly charged to rate case expense and other "cap time" categories, accordingly. In

addition, Staff recommended that the Commission order these entities to include with this testimony all supporting schedules and evidence necessary to adequately document the explanation and the amounts set forth in the ordered testimony. (Staff Ex. 11.0 at 2, 6). The Companies did not contest the adjustment or the recommendations made by Staff. The adjustment and recommendations are reasonable and are hereby approved.

4. Maintenance Expenses

Staff witness Ostrander proposed an adjustment to decrease Camelot's maintenance expenses because the unaccounted-for water percentage exceeded the maximum as defined by Camelot's tariff. (Staff Ex. 1.0, Schedule 1.16 C-W). This adjustment limits the costs ratepayers bear for unaccounted-for water to what the Commission has set forth as reasonable in Camelot's tariff. Camelot did not contest this adjustment. (GNUI/CUI/LHUC Ex. 3.0 at 5). This adjustment is reasonable and is hereby approved.

5. CPI Increases

Staff witness Bridal proposed an adjustment to disallow increases to test year expenses that are based on an inflation factor. Mr. Bridal explained that pro forma adjustments to a historical test year should be based upon known and measurable changes. Inflation factors are not known and measurable. Accordingly, the Companies' pro forma adjustments for inflation should be disallowed pursuant to 83 Ill. Adm. Code 287.40 because the adjustments are based on the Consumer Price Index, which does not represent a specific study of known and measurable changes to the test year operating expenses. (Staff Ex. 2.0 at 4). The Companies agreed with Staff's adjustment. (GNUI/CUI/LHUC Ex. 3.0 at 6). This adjustment is reasonable and is hereby approved.

6. Income Taxes

Staff witness Ostrander proposed an adjustment to income tax expense for interest synchronization. The Companies compute the interest expense (component) of their revenue requirement by multiplying their rate base by the weighted cost of their debt. The calculated interest expense is then compared to the interest expense used by the Companies in their computation of test year income tax expense. The tax effect of the difference in interest expense is the adjustment for interest synchronization. The effect of this adjustment is to ensure that the sewer and/or water revenue requirements reflect the tax savings generated by the interest component of the revenue requirements. (Staff Ex. 1.0 at 7). The Companies agreed with Staff's adjustment. (GNUI/CUI/LHUC Ex. 3.0 at 2). This adjustment is reasonable and is hereby approved.

7. Gross Revenue Conversion Factor

Staff witness Ostrander proposed an adjustment based on the gross revenue conversion factor ("GRCF"). The GRCF is applied to the operating income deficiency to

derive the change in revenue requirement. It is based upon the applicable federal income tax rate, state income tax rate, and uncollectible rate. The GRCF is used in the calculation of the revenue requirement. (Staff Ex. 1.0 at 7). The Companies agreed with Staff's adjustment. (GNUI/CUI/LHUC Ex. 3.0 at 2-3). This adjustment is reasonable and is hereby approved.

B. Contested Issues

1. Allocation Factor Corrections

a) AG's Position

~~The AG argues that~~ Staff witness Bridal's Richard W. Bridal II proposed adjustments to reflect allocation factor corrections, remove Consumer Product Index ("CPI") increases, remove public utility taxes, account for the increase in the state income tax rate, and reduce rate case expense. In addition, Mr. Bridal made recommendations regarding tariff language changes related to public utilities taxes, and additional rate case expense information to be provided by the Companies and Utilities Inc. Illinois's regulated utilities in future rate case direct testimony. These adjustments and recommendations are further described below.

Mr. Bridal proposed an adjustment to correct the amount of Water Service Corporation ("WSC") expenses allocated to the Companies. According to Mr. Bridal, the Companies used an incorrect allocation factor to calculate each utility's share of WSC expenses. This adjustment increases costs to consumers based on the Companies response to a Staff data request by "updating" the costs presented in the Companies' original Operating Statements ~~increases costs to consumers~~. (Staff Ex. 2.0, at 3). ~~The AG notes that Mr. Bridal~~ The Companies agreed with Staff's adjustment. (GNUI/CUI/LHUC Ex. 3.0, at 14) However, Staff witness Bridal also testified that his review led him to conclude the explanation provided in GNUI/CUI/LHUC Exhibit 3.0 "did not accurately reflect the process undertaken during the development of the Companies' income statement" relative to the allocation of joint company costs to the individual operating companies. (Staff Ex. 11.0 at 5). ~~The AG points out that~~ Mr. Bridal recommended that the utilities be required "to provide in direct testimony in future rate cases a detailed explanation of how Utility and WSC salaries are determined in total, allocated to the individual Utility, and directly charged to rate case expense and other "cap time" categories, accordingly. The Commission should order these entities to include with this testimony all supporting schedules and evidence necessary to adequately document the explanation and the amounts set forth in the ordered testimony." ~~{Id. at 6}~~.

The AG argued that the fact that the Companies' explanation for their allocation factor was insufficient should lead the Commission to decline to increase the costs associated with the revised allocation factors produced by the Companies in discovery. The AG maintains that the increases associated with the increased allocation of common costs to the utilities should be rejected by the Commission. Mr. Bridal proposed an adjustment to disallow increases to various Company Pro Forma Expense

Adjustments that were based on an inflation factor. (Staff Ex. 2.0, at 4) The Companies agreed with Staff's adjustment. (GNUI/CUI/LHUC Ex. 3.0, at 6) No other party set forth testimony on this issue.

Mr. Bridal proposed an adjustment to remove public utility taxes. The taxes, which are an add-on charge to customers' bills, are not an actual operating expense of the utility and should not be included in tariffed rates. (Staff Ex. 2.0, at 4-5) Also, Mr. Bridal recommended the Companies proceed in an expeditious manner to make the arrangements necessary to collect the Gross Revenues tax as a separate charge on customers' bills when the rates approved in this docket go into effect. (Staff Ex. 2.0, at 5) In conjunction with this change, Mr. Bridal recommended the Companies add the following language to their tariffs.

ANNUAL GROSS REVENUE TAX RECOVERY CHARGE

Section 9-222 of "The Public Utilities Act," as amended, authorizes a utility to recover from its Customers its liabilities to the State of Illinois for Public Utility Annual Gross Revenue Tax imposed by Section 2-202 of "The Public Utilities Act," as amended. Pursuant to Section 9-222, the Company shall charge an Additional Charge for the Public Utility Annual Gross Revenue Tax equal to 0.1 % of all billings under this rate schedule except for (a) this Additional charge for Public Utility Annual Gross Revenue Tax, (b) the Additional Charge for any Municipal Utility Tax, and (c) any other billings and billing items excluded from the base of the Public Utility Annual Gross Revenue Tax. (*Id.*)

The Companies agreed with Staff's adjustment and recommended tariff language. (GNUI/CUI/LHUC Ex. 3.0, at 6) No other party set forth testimony on this issue.

Mr. Bridal proposed adjustments to reflect the impact of the increase in the Illinois State Income Tax ("SIT") rate from 7.3% to 9.5%, effective January 1, 2011, as follows: (1) Increase state income tax expense; (2) Increase Accumulated Deferred Income Tax ("ADIT") for the shortfall resulting from the tax rate increase, to be recognized as a decrease to rate base; (3) Create a corresponding regulatory asset for the future recovery of that additional ADIT liability, to be recognized as an increase to rate base; and (4) Amortize the regulatory asset ratably over the remaining life of the depreciable assets that gave rise to the ADIT. (Staff Ex. 2.0, at 6-8) The Companies agreed with Staff's adjustment. (GNUI/CUI/LHUC Ex. 3.0, at 3) No other party set forth testimony on this issue.

Mr. Bridal proposed an adjustment to rate case expense to: (1) adjust the estimate for legal fees, (2) adjust costs for customer notices, FedEx, mailings, postage, and miscellaneous costs, (3) remove travel costs, (4) decrease the cost of WSC personnel, (5) adjust consulting fees, and (6) change the amortization period for rate case expense to five years from the three years proposed by the Companies. (Staff Ex. 2.0, at 8-13) In rebuttal testimony, the Companies provided additional detailed explanations of how the Companies account for rate case expense, and provided updated information on incurred rate case expense as of the filing of their rebuttal

testimony, along with an estimate of rate case expenses through the conclusion of the proceedings. (GNUI/CUI/LHUC Ex. 3.0, at 6-14) Staff accepted rate case expense as set forth in GNUI/CUI/LHUC Ex. 3.0 subject to one recommendation. Staff recommends the Commission order the Companies, and all related Utilities, Inc. public utilities regulated in Illinois, to provide in direct testimony in future rate cases a detailed explanation of how Utility and WSC salaries are determined in total, allocated to the individual Utility, and directly charged to rate case expense and other “cap time” categories, accordingly. The Commission should order these entities to include with this testimony all supporting schedules and evidence necessary to adequately document the explanation and the amounts set forth in the ordered testimony. (Staff Ex. 11.0, at 2 and 6) No other party set forth testimony on this issue.

The AG argues that the Commission should decline to increase the costs associated with the revised allocation factors produced by the Companies in discovery since the Companies’ explanation for their allocation factor was insufficient. The AG recommends that the Commission use the allocation factors applied by the Companies in their original filing instead.

b) Staff’s Position

Staff asserts that the Companies used an incorrect allocation factor to calculate each Utility’s share of WSC expenses. According to Staff, this adjustment merely updates the costs presented in the Companies’ original Operating Statements to reflect the allocation factor correction. (Staff Ex. 2.0 at 3).

c) Companies’ Position

It is the Companies’ position that Staff’s adjustments were made to correct the amount of WSC expenses allocated to the Companies. According to the Companies, the original filing allocated WSC expenses using outdated 2008 allocation factors. The Companies contend that the adjustment corrects the allocations by using the appropriate 2009 allocation factors. (Companies/Staff Draft Proposed Order (August 19, 2011) at 9).

d) Commission Analysis and Conclusion

~~The Commission agrees with the adjustments proposed by Staff and accepted by the Companies. It appears to the Commission that these adjustments were made to correct the Companies’ original filing which allocated WSC expenses using outdated 2008 allocation factors instead of 2009 allocation factors. The Commission finds that these adjustments appropriately address the error in the Companies’ original filing. The record does not support the AG’s recommendation to use the outdated 2008 allocation factors and that proposal is hereby rejected.~~

The Commission accepts the adjustments that were agreed to between the Companies and the Staff in their Joint Stipulation with the exception of the increase to

the allocation factors. Staff witness Bridal's testimony demonstrates that the Companies' allocation methods are less than transparent, and that the grounds for the allocation of Water Service Company costs do not result in consistent results. The Commission declines to increase the allocation to the customers of these small systems in light of the Staff's expressed concern about how the allocation of Water Service Company costs is actually done. The Commission will reverse the increase to the allocation factors contained in the Joint Stipulation and use the allocation factors the Companies applied in their original filing.

2. Camelot Estates Water System Study

a) The Association's Position

The Association argues that the expenses related to the Camelot Estates Water System Study ("Water Study") should be excluded because it was conducted for the benefit of a proposed subdivision development, Camelot Estates, which has no relation to the Camelot subdivision that Camelot currently serves. According to the Association, Camelot witness Haas' testimony initially failed to mention that Camelot Estates and the Camelot subdivision are two different entities. The Association contends that the only reason the study was conducted was because a developer of Camelot Estates contacted Camelot to inquire whether the proposed development would be able to utilize Camelot's facilities. The Association notes that Camelot stated the Water Study addressed "future potential needs, looking at additional potential water supply ...to meet regulation." However, the Association contends that the "future potential needs" explored in the Water Study were for the new proposed subdivision not for the current residents in the Camelot subdivision. (Association Initial Brief at 28). The Association states that if the developer of the proposed subdivision had not approached Camelot about hooking into its water and sewer system, the Water Study would never have been conducted. It further states that Mr. Haas' denial that the study was conducted because of the proposed subdivision is disingenuous. Finally, the Association asserts that residents in the Camelot subdivision should not have to bear the cost of a study to determine if upgrades were practicable since they would not be required to bear the expense of the actual upgrades. (*Id.*).

b) Staff's Position

Staff argues that the Association's proposal to disallow the costs of the Water Study should be rejected. Staff notes that Camelot describes this study as follows: "Engineering was performed to provide options for upgrades to Camelot's water system. This study modeled the water system to allow Camelot to prepare for future demands and needs of the water system." (Staff Reply Brief at 12). Staff notes further that the Association correctly quotes Camelot witness Haas' cross-examination reply on this subject, but leaves out the following: "that particular project or water system study was to evaluate the needs of the actual water system. During that study, we looked at a number of factors, including what were the requirements of that particular system, what future needs we may have and what future capital expenditures would be required in

order for us to meet all IEPA requirements, which as part of that study, I believe, we also looked at the water storage, the pressure storage, capabilities from our pressure tanks, we looked at alternate sources of water, including bulk service from, I believe three areas -- three municipalities around Channahon, Shorewood, and Joliet. So we had looked at -- to see what would be required for us to make sure that we met all of the IEPA requirements and as part of that process, to identify what may be required.” (*Id.*).

It is Staff’s position that the Association appears to focus solely on the title of the study (“Camelot Estates Water System Study”) without recognizing that it dealt with numerous issues, which Staff concludes are prudent costs of doing business.

Finally, Staff avers that the Association provides no basis for characterizing Mr. Haas’ response that the engineering study would have occurred without the inquiry of the Camelot Estates subdivision “disingenuous”.

c) Companies’ Position

The Companies argue that the Water Study was used to evaluate Camelot’s future needs for capital improvements to meet IEPA requirements and the costs should be recovered. It included evaluations of water storage alternatives and the potential for alternative water sources. The Companies point out that the study lead Camelot to install or replace a hydropneumatic tank within the system, to install additional storage tanks in the system and an additional storage tank with booster pumping capabilities, all of which benefit current Camelot customers. (Companies Reply Brief at 10). The Companies note that no witness rebutted this testimony. The Companies argue the Association’s argument is based on sheer speculation primarily based on a response to a data request by Camelot that it had been approached several times by a developer about its desire to utilize Camelot’s system and that its speculation should be disregarded especially since the response was not offered into evidence. (*Id.*).

d) Commission Analysis and Conclusion

The Commission rejects the Association’s proposal to exclude the costs related to the Water Study. Camelot witness Haas provided a detailed explanation of Camelot’s use of the Water Study to evaluate its future needs for capital improvements to meet IEPA requirements. Camelot undertook various capital improvements as a result of this study and Camelot’s current customers benefitted from these improvements. The Commission is not persuaded by the Association’s argument that the study was conducted for the benefit of a prospective subdivision. It is the Commission’s understanding that this type of study is routinely performed by utilities, including water utilities, and such studies are important for a utility to properly plan for the future.

C. Commission Conclusion on Operating Revenues, Expenses, and Income

As discussed above, the Commission declines to adopt the adjustments recommended by the Association and finds that the adjustments to operating revenues, expenses (including taxes) and utility operating income proposed by Staff with the exception of the allocation adjustment are supported by the evidence, reasonable, and should be adopted.

~~————The operating income statements for the Companies for the test year ended December 31, 2009 are shown in Appendices A, B, C, and D and summarized below.~~

CAMELOT

Sewer

Operating Revenues	\$201,134
Operating Expenses	<u>\$152,759</u>
Utility Operating Income	\$48,375
 Revenue Change	 \$94,259

Water

Operating Revenues	\$238,377
Operating Expenses	<u>\$161,074</u>
Utility Operating Income	\$77,303
 Revenue Change	 \$162,124

GREAT NORTHERN

Water

Operating Revenues	\$323,168
Operating Expenses	<u>\$218,032</u>
Utility Operating Income	\$105,136
 Revenue Change	 \$231,287

LAKE HOLIDAY**Water**

Operating Revenues	\$677,195
Operating Expenses	<u>\$552,184</u>
Utility Operating Income	\$125,011
 Revenue Change	 \$219,616

VII. Rate of Return**A. Capital Structure**

Since all of the Companies are wholly owned subsidiaries of UI, Staff proposes using UI's capital structure for the year ended December 31, 2009, comprised of 6.45% short-term debt, 48.75% long-term debt, and 44.80% common equity. (Staff Ex. 3.0 at 3; Schedule 3.1).

Staff witness Freetly calculated the balance of short-term debt in three steps. First, Ms. Freetly calculated the monthly ending net balance of short-term debt outstanding from June 2009 through June 2010. The net balance of short-term debt equals the monthly ending gross balance of short-term debt outstanding minus the lesser of (a) the corresponding monthly ending balance of construction-work-in-progress ("CWIP") accruing an allowance for funds used during construction ("AFUDC") or (b) the monthly ending balance of CWIP accruing AFUDC times the ratio of short-term debt to total CWIP for the corresponding month. That adjustment recognizes the Commission's formula for calculating AFUDC assumes short-term debt is the first source of funds financing CWIP⁴ and addresses the double-counting concern the Commission raised in a previous Order. Second, Ms. Freetly calculated the twelve monthly averages from the adjusted monthly ending balances of short-term debt. Third, Ms. Freetly averaged the twelve monthly balances of short-term debt for July 2009 through July 2010. (Staff Ex. 3.0 at 3-4; Schedule 3.2).

Ms. Freetly adjusted the \$180,000,000 balance of long-term debt outstanding on December 31, 2009 to reflect the unamortized debt expense incurred to issue the debt, which produces a long-term debt balance of \$178,726,842. Ms. Freetly used the \$164,229,938 balance of common shareholders equity on December 31, 2009. (*Id.* at 5).

B. Cost of Debt

Ms. Freetly estimated that the Companies' cost of short-term debt is 2.85%, which equals a weighted average of the current Prime rate and LIBOR rate that the Companies pay on short-term borrowings. The weighted cost of short-term debt was

calculated based on the proportion of the Companies' borrowings at the Prime rate and LIBOR during the short-term measurement period.

The Companies' embedded cost of long-term debt is 6.65%, which includes the annual amortization of debt expense to reflect straight line amortization of the unamortized balance over the remaining life of the outstanding issue of long-term debt. (Staff Ex. 3.0 at 8; Schedule 3.3).

C. Cost of Common Equity

Ms. Freetly recommended a 9.56% cost of common equity for UI subsidiaries Great Northern, Camelot, and Lake Holiday. She measured the investor-required rate of return on common equity for UI with the discounted cash flow ("DCF") and risk premium models. DCF and risk premium models cannot be directly applied to UI because its stock is not market traded. Therefore, Ms. Freetly applied those models to water utility and public utility samples (hereafter, referred to as "Water sample" and "Utility sample", respectively).

Staff's Water sample consists of domestic corporations classified as water utilities within Standard & Poor's ("S&P") *Utility Compustat II* that have publicly traded common stock and long-term growth rates from Zacks Investment Research ("Zacks"). (Staff Ex. 3.0 at 9). Staff's Utility sample was selected using S&P credit ratings, business risk profiles and financial risk profiles for a typical water utility since UI is not rated. Ms. Freetly concluded that a credit rating of 'A' with a business risk profile of 'excellent' and a financial risk profile of 'significant' are representative of the business and financial risk of a typical water utility and, therefore, reasonable estimates for UI. Ms. Freetly formed her sample by selecting domestic dividend paying publicly traded corporations classified as electric or gas utilities within S&P *Utility Compustat II* that: (1) have been assigned a S&P credit rating of A+, A, A- or BBB+; (2) a business risk profile score of 'excellent'; and (3) a financial risk profile of 'intermediate', 'significant' or 'aggressive'. Companies that lacked Zacks growth rates or were in the process of being acquired by another company or acquiring a company of similar size were not included in the Utility sample. (Staff Ex. 3.0 at 9-11).

1. DCF Analysis

DCF analysis assumes that the market value of common stock equals the present value of the expected stream of future dividend payments to the holders of that stock. Ms. Freetly employed a constant-growth DCF model that reflects a quarterly frequency in dividend payments. (Staff Ex. 3.0 at 11-16).

Ms. Freetly used market-consensus expected growth rates published by Zacks as of March 8, 2011. The growth rate estimates were combined with the closing stock prices and dividend data as of March 8, 2011. Based on these growth assumptions, stock price, and dividend data, Ms. Freetly's DCF estimate of the cost of common equity

was 8.59% for the Water sample and 9.45% for the Utility sample. (*Id.* at 15; Schedule 3.7).

2. Risk Premium Analysis

According to financial theory, the required rate of return for a given security equals the risk-free rate of return plus a risk premium associated with that security. Staff witness Freetly used a one-factor risk premium model, the Capital Asset Pricing Model ("CAPM"), to estimate the cost of common equity. (Staff Ex. 3.0 at 16-18).

The CAPM requires the estimation of three parameters: beta, the risk-free rate, and the required rate of return on the market. For the beta parameter, Ms. Freetly combined adjusted betas from Value Line, Zacks, and a regression analysis to estimate the beta of the Water and Utility sample. For the Water sample, the average Value Line, Zacks, and regression beta estimates were 0.69, 0.59, and 0.56, respectively. For the Utility sample, the average Value Line, Zacks, and regression beta estimates were 0.64, 0.59, and 0.55, respectively. The Value Line regression employs weekly observations of stock return data while both the regression beta and Zacks betas employ monthly observations. Since the Zacks beta estimate and the regression beta estimate are calculated using monthly data rather than weekly data (as Value Line uses), Ms. Freetly averaged those results to avoid over-weighting betas estimated from monthly data in comparison to the weekly data-derived Value Line betas. She then averaged the resulting monthly beta with the Value Line weekly beta, which produced a beta of 0.63 for the Water sample and 0.61 for the Utility sample. (*Id.* at 22-27).

For the risk-free rate parameter, Ms. Freetly considered the 0.07% yield on four-week U.S. Treasury bills and the 4.71% yield on thirty-year U.S. Treasury bonds. Both estimates were measured as of March 8, 2011. Forecasts of long-term inflation and the real risk-free rate imply that the long-term risk-free rate is between 4.5% and 5.3%. Thus, Ms. Freetly concluded that the U.S. T-bond yield is currently the superior proxy for the long-term risk-free rate. (*Id.* at 20-22).

Finally, for the expected rate of return on the market parameter, Ms. Freetly conducted a DCF analysis on the firms composing the S&P 500 Index. That analysis estimated that the expected rate of return on the market was 12.74% for the fourth quarter of 2010. (*Id.* at 22). Inputting those three parameters into the CAPM, Ms. Freetly calculated a cost of common equity estimate of 9.77% for the Water sample and 9.61% for the Utility sample. (*Id.* at 28; Schedule 3.8).

3. Staff Cost of Equity Recommendation

Staff estimates the investor-required rate of return on common equity for the two samples from the results of the DCF and risk premium analyses for the samples. The average investor required rate of return on common equity for the Water sample, 9.18%, is based on the average of the DCF-derived results (8.59%) and the risk premium-derived results (9.77%). The average investor required rate of return on

common equity for the Utility sample, 9.53%, is based on the average of the DCF-derived results (9.45%) and the risk premium-derived results (9.61%). The investor required rate of return on common equity for the Companies, 9.56%, is based on the average for the water and utility samples adjusted upward 20 basis points to reflect the higher risk of UI relative to each of the samples.

4. AG Cost of Equity Recommendation

The AG ~~recommends~~recommended that the allowed return on common equity for the Companies be reduced by no less than 100 basis points from the 9.56% ~~agreed upon by Staff and found in the Companies Joint Stipulation~~, to reflect the poor management shown by the ~~high rate increases proposed request to increase rates up to 250% in this docket~~ and other ~~consumer complaints by consumers~~. The AG ~~argues~~pointed out that ~~the a balance must be maintained between shareholders and ratepayers and the rates charged by utilities relative to the services performed. Citizens Utils. Co. of Ill. v. O'Connor, 121 Ill. App. 3d 533, 540, 459 N.E.2d 682, 688, 76 Ill. Dec. 767 (2d Dist. 1984). Although public utilities may not be required to charge a rate that is so low it can be considered confiscatory, public utilities cannot charge customers more than what the services are reasonably worth. Island Lake Water Co. v. Ill. Commerce Comm'n, 65 Ill. App. 3d 853, 857, 382 N.E.2d 835, 838, 22 Ill. Dec. 445 (2d Dist. 1978). Here, the 7.71% overall rate of return proposed is particularly concerning in the case of Camelot because there is substantial evidence in the record that Camelot customers have received substandard service. The AG also argues that Staff failed to take interderived by the Staff financial analyst did not account for the water quality or any other measure of what the services rendered by Camelot are worth which is necessary since a utility cannot charge more than a service is reasonably worth. (AG Initial Brief (Tr. at 16). The AG states~~168, July 13, 2011).

This docket includes an extraordinary number of comments and prepared rebuttal testimony from consumers reflecting their concerns about substandard water quality. "We have paid for drinking water from Hinkley since we built our home in 1984 . . . We have never trusted the tap water for drinking, cooking, etc." Prepared Rebuttal Testimony of Barb Studer at 1. "We now buy bottled water to drink and to use for coffee. We only use tap water when it is boiled first." Prepared Rebuttal Testimony of Beth Stuchly at 1. "[O]ur water gets a sulfur smell in our washer, water pressure can be low, and if you leave water in a bowl, such as a pet bowl, the bowl gets brown on the bottom." Prepared Rebuttal Testimony of Linda Hawkinson at 1. "[O]ur 'white' clothing has a tendency to turn 'yellowish' despite trying several different brands of detergents." Prepared Rebuttal Testimony of Toni Tully at 1. One homeowner describes how, countless times, she has refused to even give her dog water from her faucet because of the smell. Prepared Rebuttal Testimony of Bobbe Marion at 1. She also estimates that it she spends \$150 annually on filters to make the water drinkable. *Id.* In addition, water pressure and maintenance issues were also identified by homeowners. Prepared Direct Testimony of Barry A. Damon. It is notable that, although Camelot only serves 200 customers in one subdivision—but, 19 households have prepared and filed direct testimony in this case discussing the poor water quality provided by Camelot. The

~~customers complained about water pressure, maintenance issues and the fact that the water was undrinkable requiring them to purchase bottled water or install filters that is provided by the Utility. Fifty nine other customers filed public comments on e-docket expressing their displeasure with the increase, their negative perception of the quality of service, or the burden that this increase will place on their budgets.~~

~~The AG maintains~~In addition to the service problems identified in the record, AG witness Roger Colton demonstrated that the rates ~~agreed upon~~requested by the ~~Companies~~Company and the Staff ~~are out of line with comparable utility rates, resulting in the proposed~~its Direct Testimony would place the water ~~rates~~rate for Great Northern and Camelot ~~being among the highest in~~rates reported by both ICC regulated utilities and non-regulated water utilities and several times higher than the average rates for these services. For example the Great Northern water rate would be 229% and 213% higher than the state. ~~(average using the Carbondale and the ICC rate surveys, respectively. Camelot's water and sewer rates would be 298% and 329% higher than the Carbondale survey average and 276% and 221% higher than the ICC rate survey. AG Ex. 1.0 at 9-10.)~~ The AG argues. Not only are the fact that the proposed increases ~~are not only~~ large, but the ultimate rates for these services are extraordinarily high, ~~raises~~raising the question of whether the Companies should receive the same profit level as utilities that can operate at rates that are more in line with each other and with the value of the service they perform.

~~The AG also contends~~Along with Suzanne Basak of the Camelot Homeowners Association, AG witness Colton discussed the burden that the rate increases ~~will result in rate shock and place a significant financial burden of this level can be expected to impose on ratepayers who are consumers. Most consumers already facing~~face financial pressure. ~~AG witness Colton testified due to the fact that their incomes do not meet the "self-sufficient" level necessary to cover all basic expenses. AG Ex. 1.0 at 25.~~ The AG argued that Mr. Colton's schedule RDC-6 shows that the average annual wage per job in the three counties in which the Companies operate have been well below the ~~level necessary to cover basic expenses. (AG Ex. 1.0 at 25)~~self sufficiency standard, which ranges from \$42,853 to \$54,804 per year. When the problems of unemployment and living on a fixed income are considered (see, e.g., the Prepared Direct Testimony of Suzanne Basak of the Camelot Homeowners Association), the rate shock and burden of water and sewer bills of more than \$70 per month is clear.

The AG asserts that these factors should lead the Commission to reduce the Companies' return on equity by at least 100 basis points. The AG ~~points~~pointed out that ~~Staff's~~Staff DCF analysis for water utilities produced a return on equity of 8.59%, which is only 3 basis points higher than the ~~AG's recommendation. (Id.)~~People recommend in this docket. *Id.* Staff witness Freetly's analysis shows that water utilities' returns were as low as 7.22%, and that four of the seven sample companies had return on equity of less than 8.0% ~~according to the AG.~~ The AG maintains that ~~a return on equity of the ROE for the Utilities should be~~ no more than 8.56% ~~%. That return~~ is reasonable and is supported by the record. It is also necessary to protect consumers from paying

excessive profits to a utility that has failed to control costs and honor the regulatory compact.

5. Commission Analysis and Conclusions

~~The Commission rejects the AG's recommendation to reduce the Companies' return on equity by at least 100 basis points to reflect poor management. We have reviewed the evidence regarding the cost of common equity and conclude that Staff witness Freetly's analysis is based on financial theory, there are no fundamental problems with her implementation, and the results are reasonable. Moreover, the AG failed to provide a cost of equity expert witness. Staff witness Freetly, unlike the AG, actually assessed the risk associated with investing in the common equity of the Companies. This is the basis upon which the cost of common equity is normally evaluated. While the Commission certainly understands the concerns raised by the AG, reducing the revenue available to the Companies will not assist in attempting to resolve such concerns. Additionally, the Commission finds that in this instance, the AG's recommendation would be inconsistent with the reasonable standards by which the rate of return must be established.~~

~~Having reviewed the record, the Commission finds that the Companies should be authorized to earn a rate of return of 7.71% as recommended by Staff. The rate of return incorporates a return on common equity of 9.56%. The Companies' rate of return was derived as follows:~~

~~The Commission finds the position of the AG compelling. The Commission is concerned about the length of time between rate cases, the rate shock associated with the large requested increases, and the extent of the public complaints about service and water quality. We cannot accept the profit level in the Joint Stipulation because it does not make any adjustment for any of these factors. We accept the return on equity adjustment recommended by the AG and will authorize an ROE of 8.56%, resulting in the following weighted average cost of capital.~~

<u>Short-term Debt</u>	<u>\$23,636,684</u>	<u>6.45%</u>	<u>2.85%</u>	<u>0.18%</u>
<u>Long-term Debt</u>	<u>\$178,726,842</u>	<u>48.75%</u>	<u>6.65%</u>	<u>3.24%</u>
<u>Common Equity</u>	<u>\$164,229,938</u>	<u>44.80%</u>	<u>8.56%</u>	<u>3.83%</u>
<u>Total Capital</u>	<u>\$366,593,464</u>	<u>100.00%</u>		
<u>Weighted Average Cost of Capital</u>				<u>7.25%</u>

Weighted Average Cost of Capital

<u>Source of Capital</u>	<u>Amount</u>	<u>Percentage</u>	<u>Cost</u>	<u>Weighted Cost</u>
Short-term debt	\$23,636,684	6.45%	2.85%	0.18%
Long-term debt	\$178,726,842	48.75%	6.65%	3.24%
Common Equity	<u>\$164,229,938</u>	<u>44.80%</u>	<u>9.56%</u>	<u>4.28%</u>
Total	\$366,593,464	100.00%		7.71%

VIII. Rate Design/Tariff Terms

A. Rate Design

Staff contends the Companies' rate design proposals are reasonable. However, Staff recommends the Commission set the rates based upon Staff's proposed revenue requirement, by multiplying the Companies' proposed customer and usage charges by the ratio of Staff's proposed revenue requirement to the Companies' proposed revenue requirement across-the-board. The Companies agree with Staff's recommendation. The Intervenor did not present testimony on rate design but they contest the amount of the rate increases which is discussed in further detail in Section IX of this Order.

The Commission finds the development and design of the rates in the manner agreed upon by the Companies and Staff are reasonable and should be accepted.

B. Miscellaneous

1. After-Hours Call-Out Charge

The Companies propose establishing an After-Hours Call-Out charge. The Companies propose a minimum rate to be equal to two hours of current labor rate or \$106. For all time accumulated above the two-hour minimum, the Companies propose to bill customers at the rate of \$53 per hour. In response to a Staff Data Request, the Companies documented the average operator overtime costs and customer service costs to process the overtime request, and round-trip mileage to premises. Furthermore, the Companies state that such a minimum charge would act as a deterrent in instances when a customer calls and requests service for an issue that can be otherwise handled during normal business hours. Staff states the Companies have demonstrated the charge is reasonable and Staff recommends approving the After-Hours Call-Out charge. This proposal is reasonable and is hereby approved.

2. Reconnection Charge

The Companies propose increasing their reconnection charges from \$20 to \$37.50 to recover the current average cost of labor for one hour of employee time to provide reconnection service. Based on a review of the data provided by the Companies, Staff avers that the proposed increase is reasonable and recommends the increase be approved. This proposal is reasonable and is hereby approved.

3. Non-Sufficient Funds Charge

The Companies propose increasing the Non-Sufficient Funds ("NSF") Check charge from \$7 (\$10 for Great Northern) to \$25. Staff contends that based on the information provided, the \$25 NSF charge proposed by the Companies is reasonable and should be approved. This proposal is reasonable and is hereby approved.

4. New Customer Charge

The Companies propose increasing the charge for a new service application from \$15 to \$25. Based on a review of the data provided by the Companies, Staff contends that the proposed increase is reasonable and recommends the increase be approved. This proposal is reasonable and is hereby approved.

5. Billing Cycles

Lake Holiday proposes changing the billing cycle for usage customers from quarterly to monthly and to keep billing availability customers on a quarterly basis as is currently the case. Camelot proposes changing the billing cycle for all Camelot customers from bi-monthly to monthly. The Companies state that a monthly billing cycle will enable these utilities to provide better service to customers. According to the Companies, the advantages include customers being able to properly budget for water and wastewater utility expenses, expeditious detection of customer concerns and resolution of system problems, and shorter response times to unaccounted for water and water loss issues because those issues could be looked into and resolved on a monthly basis versus a quarterly or bi-monthly basis. In addition, the availability customers for Lake Holiday will have minimal monthly bills, thus the Companies argue that continuing quarterly billing would be more cost effective and would allow its availability customers the convenience of writing four checks a year instead of twelve. Staff agrees that the benefits of the billing cycle changes listed above will improve the efficiency of the quality of service the Companies can provide to their customers and recommends the Commission approve this modification. This proposal is reasonable and is hereby approved.

6. Customer Bill Form

Camelot and Lake Holiday currently have bill forms on file as tariff sheets, although they will be outdated at the conclusion of this consolidated rate case. Great Northern, however, does not have a bill form on file currently as a tariff sheet. Staff notes that electric and gas utilities are already required to have their bill forms filed as a tariff sheet, and it would be useful to customers, Staff, and the Commission for water and sewer utilities to do likewise. Staff explains that having the bill form as a filed tariff sheet is desirable because it would provide openness and transparency of billing information to the utility customers, to the Commission and the general public. Accordingly, Staff recommends that the Commission require Great Northern to provide a copy of its bill form as a filed tariff sheet. This recommendation is reasonable and is hereby approved.

7. Tariff Updates

Lake Holiday's current Schedule of Rates for Water Service tariff sheets have various effective dates that include August 31, 1966, October 24, 1980, August 31,

1991, August 11, 1993, and February 12, 2007. Great Northern's current Schedule of Rates for Water Service tariff sheets have various effective dates that include December 5, 1975, November 14, 1998 and February 12, 2007. Camelot's current Schedule of Rates for Water Service tariff sheets have various effective dates that include April 12, 1977, April 15, 1977, October 24, 1980, September 21, 1984, August 31, 1991, July 19, 1993, and February 12, 2007. Camelot's current Schedule of Rates for Sewer Service tariff sheets have various effective dates that include April 15, 1977, September 21, 1984, August 31, 1991, and July 19, 1993. Staff recommends that all tariff sheets included in the Companies Schedule of Rates for Water Service be filed as part of their compliance filings. Their current Schedule of Rates for Water Service tariffs (ILL. C.C. No. 1, Eighth Revised Sheet No. 1 for Lake Holiday; ILL. C.C. No. 3, Eleventh Revised Sheet No. 1 for Great Northern; and ILL. C.C. No. 3, Seventh Revised Sheet No. 1 for Camelot) and Sewer Service tariffs (ILL. C.C. No. 3, Sixth Revised Sheet No. 1 for Camelot) should be replaced with updated rates and the miscellaneous tariff charges. Staff also recommends that all filed tariff sheets for each of the Companies have a uniform and standard presentation.

Currently Great Northern has a construction fee that is described in its Rules, Regulations, and Conditions of Service tariffs for water service. This fee is not addressed on their current or proposed rate tariff sheet, and is not included in Staff's proposed Rules, Regulations, and Conditions of Service tariffs for water service. In Staff's opinion, rates should be separately stated on rate tariff sheets for the convenience of customers and so there is no confusion about what water rates apply. To address this issue, Staff proposes that this \$10 charge be included within Great Northern's Schedule of Rates for Water Service as part of its compliance filing. Additionally, Lake Holiday currently lists a \$400 installation fee in its Rules, Regulations, and Conditions of Service tariffs for water service. Staff recommends that this charge be included within Lake Holiday's Schedule of Rates for Water Service as part of its compliance filing. Camelot currently lists a \$200 connection charge per Population Equivalent in its Rules, Regulations, and Conditions of Service tariffs for sewer service. Staff recommends that this charge be included within Camelot's Schedule of Rates for Sewer Service as part of its compliance filing. This recommendation is consistent with Staff's recommendation that all of the Companies' rate charges be placed in the Companies' rate tariffs.

Lake Holiday and Camelot have tariff sheets that cancel riders pursuant to the Orders in Docket Nos. 87-0601 and 87-0556, respectively, which dismissed proceedings investigating the ratemaking impact of the Tax Reform Act of 1986. Staff recommends the Commission order Lake Holiday and Camelot to remove these sheets. These respective Riders have all been cancelled pursuant to the Commission's prior Orders, so including them in Lake Holiday's or Camelot's updated tariff sheets serves no purpose. These recommendations are reasonable and are hereby approved.

C. Rules, Regulations, and Conditions of Service Tariffs

Staff proposes new Rules, Regulations, and Conditions of Service Tariffs for sewer and water service for Camelot, (Staff Exhibits 8.1 and 8.2, respectively) and new

Rules, Regulations, and Conditions of Service Tariffs for water service for Great Northern (Staff Exhibit 7.0, Attachment 7.01 GN) and Lake Holiday (Staff Exhibit 9.0, Attachment 9.01 LH). The Companies agree with Staff's proposed Rules, Regulations, and Conditions of Service Tariffs for water and sewer service. This proposal is reasonable and is hereby approved.

D. Commission Analysis and Conclusions

The Commission finds the rate design principles and cost-of-service methodologies proposed in Staff's testimony, and the development and design of the rates in the manner proposed by Staff are reasonable. We conclude, therefore, that Staff's proposals are adopted.

IX. Rate Shock

A. AG's Position

The AG argues the proposed rate increases agreed to by Staff and the Companies constitute rate shock. AG witness Colton criticized Staff for focusing on the needs of shareholders and failing to consider the effect of the increases on ratepayers. Mr. Colton ~~compared the proposed rates with presented~~ two rate surveys ~~and concluded the proposed rates for Camelot and, both of which showed that the requested increases at a 237% level would put~~ Great Northern ~~would result in some of the highest rates higher than most other water utilities~~ in Illinois. ~~(AG Initial Brief at 5).~~ The ~~proposed rates for increases would also put Camelot water and wastewater rates and~~ Lake Holiday ~~would be close to the statewide average reported in the rates higher than most other water utilities in Illinois.~~

~~The Carbondale survey was based on surveys according to returned by 256 jurisdictions across Illinois and the ICC water and wastewater survey included systems serving fewer than 1,000 customers. AG Ex. 1.0 at 9-10 & App. C and D. Mr. Colton but he expressed concern about the suddenness of the increase. To address the issue of showed that if Great Northern rates were increased by 237%, consumers would experience rate shock, and pay 229% or 213% more than the average of the Carbondale and ICC surveys. AG Ex. 1.0 at 9, 10. Mr. Colton recommended that, "at a minimum, the Companies Company should be required to refile their rate increases demonstrating how they will address rate shock by deferring cost recovery or phasing in rate increases over a reasonable period of time. (" AG Ex. 1.0 at 27).~~

The AG contends that the proposed rate increases also violate the regulatory compact between consumers and utilities as well as the doctrines of gradualism, rate continuity, and promissory estoppel. By requesting such large and sudden increases, the AG maintains, the Companies breached an unambiguous promise to consumers that they will manage their operations to incorporate the concepts of gradualism and rate continuity so that rates are predictable, just and reasonable. (AG Initial Brief at 21). In the AG's view, Illinois consumers detrimentally relied on the assumption that this promise would be fulfilled.

B. The Association's Position

It is the Association's position that Camelot's proposed rate increase violates the fundamental principle of gradualism and if approved will result in unprecedented rate shock. (Camelot Initial Brief at 5). The Association argues Mr. Colton's testimony supports this fact since his comparison of Camelot's proposed water and wastewater rates with two rate surveys demonstrated Camelot's rates will be among the highest in Illinois if the increase is approved. The Association also argues that Camelot's proposed rate increase violates the doctrine of laches. According to the Association, Camelot should not be awarded with higher rates because they have not had an

increase in almost two decades since it was the Company's responsibility to seek an increase earlier if it was necessary. The Association points out Mr. Colton's testimony that the length of time since Camelot's last rate increase does not mitigate the impact of the rate shock caused by the rate increase. (Camelot Initial Brief at 13).

The Association further argues that Camelot and Staff failed to analyze the severe financial impact of the proposed increases on the ratepayers, especially those on fixed incomes or unemployed. According to the Association, Camelot and Staff also failed to consider Camelot customers will be required to pay more despite the fact that 19 Camelot customers filed rebuttal testimony concerning the poor quality of the water provided by Camelot.

The Association recommends that the Commission take one of the three following actions to solve the issue of rate shock: 1) reject Camelot's proposed rate increase; 2) direct Camelot to refile its rate case after it has determined how to address the rate shock, by deferring cost recovery or phasing in fair rate increases over a reasonable period of time that is commensurate with the ability of the Association members to bear such increases; or 3) stay any water rate increase until such time as Camelot has undertaken a water quality survey and other appropriate measures to improve the quality of the water it provides. (Camelot Reply Brief at 13).

C. Staff's Position

Staff asserts that its thorough review of the Companies' cost of providing service revealed their current rates are insufficient to generate the operating revenue necessary to permit them to earn a fair and reasonable rate of return and to cover their expenses to operate and maintain their systems. (Staff Initial Brief at 17). Staff argues the Intervenor failed to: 1) conduct a comprehensive analysis of the accounting and financial evidence, 2) recommend their own alternative approaches to revenue allocation or rate design, or 3) address any specific component of the Companies' testimony on operating or capital costs, choosing to instead merely urge the Commission to deny certain costs as imprudent in their briefs. (*Id.*). Moreover, Staff contends the recommendations made by the Intervenor will move rates away from costs and violate the well-established Commission policy of basing rates, to the extent possible and reasonable, on cost. Staff contends that the rates it proposed are slightly lower than those proposed by the Companies and the percentage increases might be considered steep in some circumstances but the increases are necessary in order for the Companies to recover their revenue requirement. (*Id. at 22*).

Staff also argues that the rate surveys used by AG witness Colton do not support his position that the proposed rates are out-of-line with comparable water and sewer rates. First, many of the utilities cited in the 2010 Carbondale Survey are non-regulated entities ("MOUs") which have a cost structure very different from investor-owned utilities ("IOUs") like the Companies that are regulated by the Commission. Second, comparisons of MOU and IOU rates are meaningless since the Commission establishes rates based on cost of service and not comparisons of adjacent or regional utility rates.

(*Id.*). Third, Mr. Colton did not provide any cost of service studies or any other information that establishes the comparability of the MOUs systems' costs to the Companies' systems' costs (other than the rate comparisons presented in his testimony). Fourth, Mr. Colton has no basis to conclude that any cost incurred by the Companies is excessive or unreasonable since he provided no analysis evaluating the reasonableness of any specific cost incurred by the Companies. Fifth, the Companies presented detailed evidence regarding their specific operating and capital expenses, but Mr. Colton failed to provide any analysis of the Companies' revenue requirement at all. Finally, Mr. Colton recommends that the Commission mitigate rate shock by declining the Companies' request for a rate increase but the Commission is not free to just say no to a rate increase. Staff argues the Commission must "consider the revenues and expenses of the utility" when considering a rate increase. (*BPI* at 219).

Staff posits that the Intervenor's arguments asserting equitable relief should be rejected because the Commission does not have legal authority to provide such relief. In addition, laches and promissory estoppel are inapplicable since there is no such thing as a regulatory compact, utilities can file a rate case whenever they want and the Commission cannot require or prevent a utility from filing a rate case. (*Id.* at 6).

With respect to Camelot, Staff argues the Association repeatedly uses flawed mathematics in its attempts to exaggerate Camelot's proposed rates. For instance, while the Association correctly notes that "proposed water rate increases range as high as 632%," it fails to explain that the 632% increase is for the base facility charge which is only a portion of the overall water rate and this charge only applies to five customers. In addition, the Association fails to explain that Camelot does not currently have any customers that would be subject to a 632% increase in the overall water rate. (Staff Reply Brief at 11).

D. Companies' Position

The Companies maintain that the evidentiary record supports the proposed rate increases. The Companies have experienced rising costs since their current rates were approved and their operating expenses now exceed operating revenues resulting in overall negative return on rate base. Staff performed an all-embracing investigation of the Companies operations and came to the same conclusion as the Companies, that they have not and will not recover their costs of service under their current rates. The Intervenor's did not present any testimony to the contrary. In addition, while Staff and the Companies provided testimony supporting the proposed increases, the Intervenor's did not provide any testimony rebutting Staff's conclusions regarding rate of return or identifying a specific expenditure that was unnecessary, costs that could have been reduced or acceptable service cutbacks to reduce rates.

The Companies argue that none of the legal authority cited by the Intervenor's supports the argument that rate shock or gradualism provide the Commission the authority to approve a revenue requirement that does not fully recover a utility's cost. (Companies Reply Brief at 3). In addition, the Companies state that they took

customers' concerns about rates into account by adopting the adjustments proposed by Staff. (*Id.*). The Companies aver that Staff's reduced rate increases are essential for the Companies to recover the costs incurred in meeting their service obligations and that they must satisfy these obligations without exception for difficult economic circumstances. (*Id.* at 4; 220 ILCS 5/8-401).

The Companies contend that the Commission should disregard AG witness Colton's testimony. First, Mr. Colton failed to show that the rates proposed by Staff are substantially out-of-line with comparable water and sewer rates. Second, the Companies contend that the revenue increases recommended by Staff are consistent with increases in operating expenses and rate bases that have occurred over the past 13 or 18 years since the current rates were set. (Companies Initial Brief at 5). Third, customers benefitted from the Companies' decision not to file rates cases more frequently because they avoided paying additional rate case expenses and their lower rates were subsidized by investors. Fourth, Mr. Colton did not provide an alternative plan for a more gradual rate modification. Fifth, Mr. Colton's statement that the increases are sudden is false. The Companies assert that the 11 month rate case process in Illinois allows customers time to plan for and adjust their budgets and usage to avoid financial problems that may result from the increased cost of service. In addition, the Companies note that the Commission's rules provide for alternative payment arrangements to assist a customer who may experience a hardship and cannot afford to pay his or her bill. (*Id.* at 6; 83 Ill. Adm. Code 280).

The Companies concur with Staff that the common law defenses of laches and estoppel should be rejected. They point out that the Appellate Court has flatly rejected the argument that customers have a right to rely on continued below cost rates, holding in *Commonwealth Edison v. Illinois Commerce Commission*, 924 N.E.2d (2d Dist. 2009) that "there is no protected interest in the continuation of favorable utility rates."

Finally, Camelot argues that its water meets or exceeds all applicable IEPA standards for safe drinking water and those customers that view the water as undrinkable have a preference for better tasting water that is expensive to produce. (Companies Reply Brief at 8). Camelot points out that before its rate case was filed, it had only received four quality/service complaints during the last 12 months and none in 2010. In addition, Camelot notes that there is no evidence in the record that Camelot's water quality is materially different from the quality of water supplied by other utilities that rely on northern Illinois well water or that the quality was a result of any lack or care or diligence on the part of Camelot.

E. Commission Analysis and Conclusions

The Commission is concerned about the extraordinary increase requested in Great Northern rates and finds that the increase associated with the Joint Stipulation, which is 251.72%, constitutes rate shock. The increases proposed by Staff resulting from the Joint Stipulation are reasonable, supported by the evidence, and should be adopted. While the 260% for Great Northern water service. GN Ex. 5.0, Sch. 5.1 GN.

The Commission is mindfulalso concerned about the extraordinary increase requested in Camelot rates and finds that the increases associated with the Joint Stipulation, which are not small and economic conditions175.82% and 71.87% for water and wastewater rates respectively, constitute rate shock. The increases resulting from the Joint Stipulation are difficult, the Commission simply193% for water for 5/8 inch meter customers and 218% for usage charges. Camelot Ex. 5.0, Sch. 5.1-R-C-W. The increases for customers with larger water meters are even more extreme, with 1 inch meter rates increasing 632% and ¾ inch meters increasing 339%. The Camelot sewer rates would increase 89% under the Joint Stipulation. Id. at Sch. 5.1-R-C-S.

Lastly, the Commission is concerned about the increase requested in Lake Holiday rates and finds that the increase resulting from the Joint Stipulation, which is 45.60%, constitutes rate shock even though the resulting rate would approximate the statewide average.

The magnitude of these increases, even after being reduced as a result of this order's disallowance of substantial rate base additions and a reduction in the return on equity, requires us to take special steps to protect consumers. The increases requested will put the rates for the essential water service several times higher than the average rates of both regulated and unregulated water and sewer utilities, and we cannot deny a rate increase in approve the steep increases that will increase consumers bills to that level essentially overnight. We decline to increase rates more than 10% and direct the Company to file a petition with its entirety because the resulting rates are deemed "too high" by oneproposal of how to reduce the impact of its rate increase and address rate shock. This can be done on rehearing or more in a separate petition, where all parties can participate.

~~A utility is entitled under the Act to recover its cost of providing utility service and earn a fair rate of return on assets used to provide such service. The record evidence supports the Companies' and Staff's position that the Companies' cannot recover their costs of service under their current rates and that the rates proposed by Staff are necessary for the Companies to recover the costs incurred in meeting their public utility service obligations, including a reasonable rate of return on utility assets. Based on the Commission's review of the record, both the Companies and Staff considered the financial impact of the rates and made significant efforts to establish rates as low as possible, while ensuring each Company a fair and reasonable rate of return on investments. Unfortunately, the Intervenor's failed to provide any viable solutions to avoid or mitigate any potential rate impact on customers. In summary, there is no legal basis for the Commission to reject a rate increase that reflects the reasonable cost of providing utility service and instead direct the Companies to refile a rate increase request.~~

X. Findings and Ordering Paragraphs

The Commission, having given due consideration to the entire record herein and being fully advised in the premises, is of the opinion and finds that:

- (1) Great Northern, Camelot, and Lake Holiday provide water or water and sewer service to the public within the State of Illinois and, as such, are public utilities within the meaning of the Act;
- (2) the Commission has jurisdiction over the Companies and the subject-matter herein;
- (3) the recitals of fact and conclusions reached in the prefatory portion of this Order are supported by the evidence and are hereby adopted as findings of fact;
- (4) a test year ending December 31, 2009 should be adopted for the purpose of this rate proceeding;
- (5) for the test year ending December 31, 2009 and for the purposes of this proceeding, the rate bases for the Companies are as follows:

Great Northern – Water:	\$1, 363,884 <u>000,474</u>
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Camelot – Water:	\$1,002,814
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Camelot – <u>Water and</u> Sewer:	\$ 627,548 <u>869,318</u>
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Lake Holiday – Water:	\$ 1,621,701 <u>14,650</u>
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- (6) The \$1,806,527 original cost of the water plant in service for Great Northern at December 31, 2009, as reflected on Great Northern's Schedule C, Column Per Books, is unconditionally approved as the water original costs of plant;
- (7) The \$1,094,887 original cost of the sewer plant in service for Camelot at December 31, 2009, as reflected on Camelot's Schedule C, Column Per Books, is unconditionally approved as the sewer original costs of plant;
- (8) The \$1,019,565 original cost of the water plant in service for Camelot at December 31, 2009, as reflected on Camelot's Schedule C, Column Per Books net of Staff adjustments, is unconditionally approved as the water original costs of plant;
- (9) The \$2,886,381 original cost of the water plant in service for Lake Holiday at December 31, 2009, as reflected on Lake Holiday's Schedule C, Column Per Books, is unconditionally approved as the water original costs of plant;

- (10) a fair and reasonable rate of return on the Companies' rate bases is 7.7426%; this rate of return reflects a fair and reasonable return on common equity of 98.56%; rates should be set to allow the Companies an opportunity to earn that rate of return on their rate bases, as determined herein;
- (11) the Companies' rates, which are presently in effect are insufficient to generate the operating income necessary to permit the Companies to earn a fair and reasonable rate of return; those rates should be permanently canceled and annulled as of the effective date of the new tariffs allowed in this Order;
- (12) the rates proposed by the Companies in this proceeding would produce rates in excess of that which is fair and reasonable; the Companies' proposed rates should be rejected and the design of the rates in the manner proposed by Staff is reasonable and should be adopted;
- (13) Great Northern, Camelot, and Lake Holiday should be permitted to file new tariff sheets setting forth the rates designed to produce annual operating revenues as follows:

Great Northern – Water:	<u>\$323,168,282,792</u>
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Camelot – Water:	\$238,377
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Camelot – <u>Water and</u> Sewer:	<u>\$201,134,338,435</u>
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Lake Holiday – Water:	<u>\$677,195,523,866</u>
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as such revenues are necessary to provide the Companies a rate of return of 7.7426% on their rate bases, consistent with the findings herein; these tariff sheets shall be applicable to service furnished on or after the effective date;

- (14) the ~~rates~~rate design proposed by Staff that are contained in Section VIII hereto are designed in accordance with the rate design determinations made in the prefatory portion of this Order herein above; the Companies ~~should be~~are authorized to file new tariffs setting forth the rates and charges contained in Section VIII, effective for all service rendered on and after five (5) business days after filing, with the tariff sheets to be corrected within that time period, if necessary, except as is otherwise required by Section 9-201(b) of the Act as amended;

- (15) the proposed water and sewer depreciation rates by Staff (Identified in Staff Ex. 9.0, Schedules 9.01 C-W, 9.01 C-S, 9.01 GN, and 9.01 LH) are approved;
- (16) the Companies shall otherwise perform all actions that this Order requires of it;
- (17) ~~a~~The Commission reverses the Administrative Law Judge's order granting the Staff's Motion to Strike Portions of the AG's Initial Brief. All remaining motions, petitions, objections, or other matters in this proceeding should be disposed of in a manner consistent with the conclusions reached herein; and
- (18) the proposed Rules, Regulations, and Conditions of Service tariffs for water and sewer service proposed by Staff and accepted by the Companies are approved.

IT IS THEREFORE ORDERED by the Illinois Commerce Commission that the tariff sheets proposing a general increase in water and sewer rates filed by Great Northern Utilities, Inc., Camelot Utilities, Inc., and Lake Holiday Utilities Corporation on December 22, 2010 and December 30, 2010 be, and the same are hereby, permanently canceled and annulled.

IT IS FURTHER ORDERED that Great Northern Utilities, Inc., Camelot Utilities, Inc., and Lake Holiday Utilities Corporation file new tariffs within five (5) business days of the Order, with an effective date of not less than five (5) business days after the date of filing, except as otherwise authorized by Section 9-201(b) of the Public Utilities Act amended, for service rendered on and after their effective date, with individual tariff sheets to be corrected within that time period if necessary. The rates will be in accordance with Findings (13) and (14) above and Section VIII herein. Said new tariff sheets shall cancel the tariff sheets presently in effect for Great Northern Utilities, Inc., Camelot Utilities, Inc., and Lake Holiday Utilities Corporation, with the cancellation date being the same as with the effective date of the new rate tariffs.

IT IS FURTHER ORDERED that the new rate tariffs include provisions for the collection of the Gross Revenue tax (also known as the Public Utility Fund tax) as a separate charge on customers' bills when the rates authorized in this docket go into effect. In conjunction with this change, the following language should be added to Great Northern Utilities, Inc.'s, Camelot Utilities, Inc.'s, and Lake Holiday Utilities Corporation's tariffs:

ANNUAL GROSS REVENUE TAX RECOVERY CHARGE

Section 9-222 of "The Public Utilities Act," as amended, authorizes a utility to recover from its Customers its liabilities to the State of Illinois for Public Utility Annual Gross Revenue Tax imposed by Section 2-202 of "The

Public Utilities Act," as amended. Pursuant to Section 9-222, the Company shall charge an Additional Charge for the Public Utility Annual Gross Revenue Tax equal to 0.1 % of all billings under this rate schedule except for (a) this Additional charge for Public Utility Annual Gross Revenue Tax, (b) the Additional Charge for any Municipal Utility Tax, and (c) any other billings and billing items excluded from the base of the Public Utility Annual Gross Revenue Tax.

IT IS FURTHER ORDERED that the \$1,806,527 original cost of the water plant in service for Great Northern Utilities, Inc. at December 31, 2009, as reflected on Great Northern Utilities, Inc.'s Schedule C, column Per Books, is unconditionally approved as the water original costs of plant.

IT IS FURTHER ORDERED that the \$1,094,887 original cost of the sewer plant in service for Camelot Utilities, Inc. at December 31, 2009 as reflected on Camelot Utilities, Inc.'s Schedule C, column Per Books, is unconditionally approved as the sewer original costs of plant.

IT IS FURTHER ORDERED that the \$1,019,565 original cost of the water plant in service for Camelot Utilities, Inc. at December 31, 2009, as reflected on Camelot Utilities, Inc.'s Schedule C, column Per Books, less adjustments made by Staff of the Illinois Commerce Commission, is unconditionally approved as the water original costs of plant.

IT IS FURTHER ORDERED that the \$2,886,381 original cost of the water plant in service for Lake Holiday Utilities Corporation at December 31, 2009, as reflected on Lake Holiday Utilities Corporation's Schedule C, column Per Books, is unconditionally approved as the water original costs of plant.

IT IS FURTHER ORDERED that Great Northern Utilities, Inc., Camelot Utilities, Inc., Lake Holiday Utilities Corporation, and all related Utilities, Inc. public utilities regulated in Illinois, shall provide in direct testimony in future rate cases a detailed explanation of how Utility and Water Service Corporation salaries are determined in total, allocated to the individual Utility, and directly charged to rate case expense and other "cap time" categories.

IT IS FURTHER ORDERED that any motions, petitions or objections made in this proceeding, and not otherwise specifically disposed of herein, are hereby disposed of in a manner consistent with the conclusions contained herein.

IT IS FURTHER ORDERED that, subject to the provisions of Section 10-113 of the Public Utilities Act and 83 Ill. Adm. Code 200.880, this Order is final; it is not subject to the Administrative Review Law.